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CRAIG WILLEKE'S FINANCIAL NEWS

DIGEST



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A Great Year for a Roth Conversion

Courtesy of Craig Willeke, LUTCF, CLTC

A down stock market and the waiver of required minimum distributions in 2020 have created an ideal time to consider converting retirement savings from a traditional individual retirement account to a Roth IRA.


Unlike traditional IRAs, withdrawals from a Roth are tax free in retirement because the contribution was made with your after-tax dollars. The catch is that taxes are owed on the conversion amount for the year the conversion is made.

Those taxes, however, have just gotten more affordable if your balance is down. A shrunken retirement savings portfolio has less to tax.

For retirees with other sources of income, there's the added bonus of skipping a 2020 required minimum distribution from traditional IRAs, 401(k)s and similar plans. In any other year, those distributions, which are mandatory starting at age 72 and taxed as ordinary income, would only add to your tax burden.

Retirees who don't need their 2020 RMD should consider converting to a Roth an amount equal to that waived distribution.

For people nearing retirement who are typically in their highest earning years, Roths are attractive savings vehicles.

Even high earners, who may not be eligible to contribute to a Roth, can contribute to a traditional IRA and convert it to a Roth, a strategy known as a "backdoor" Roth IRA. 



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401(k) investors stop searching for funds too quickly. When investors find an acceptable option in lists that typically are alphabetized, they tend to stop there rather than examining other options. This could mean that they are missing out on less expensive or more appropriate investments farther down the list. *Recent finding:* Each of the top four funds in an alphabetical list gets 10% more investment money, on average, than they would receive if money was evenly allocated to all funds. *Source: Bottom Line Personal 2020*

How to handle tax identity theft. If someone files a tax return in your name, you probably will not find out until your legitimate return is rejected. If that happens, *immediately file a paper return—and attach Form 14039, Identity Theft Affidavit,* to it. *File a police report*—the police are unlikely to find the identity thief, but the report may help you fight debt-collection efforts resulting from the phony return. *Also file a report with the Federal Trade Commission* at IdentityTheft.gov. *Use IRS form 4506-F* to get a copy of the return that the scammer filed. *Check your credit report and account statements* for further evidence of fraud. *Put a credit freeze on your accounts* with Equifax, Experian and TransUnion. *Source: Money, USNews.com 2020*

"I'd like to live as a poor man with lots of money."
—Pablo Picasso



How to Manage Risk in Investing

By Elliott Raphaelson, Tribune Content Agency

When we are in a bull market, investors are not very concerned about risk. When we are in a bear market, and we see our portfolio drop frequently in value, reality forces us to recognize that real investment risk.

In November 2018, I favorably reviewed a book written by Howard Marks, a successful manager of Oakmark mutual funds. In the book, “The Most Important Thing,” Marks devoted three excellent chapters to the issue of risk.

Marks points out that different investors look at risk differently. For example, the manager of a pension fund might need an average return of 8% per year to meet its pensioners’ obligations. Ordinary retirement investors can be more conservative. Marks believes that “recognizing risk often starts with understanding when investors are paying it too little heed, being too optimistic and paying too much for an asset as a result.”

In a CNBC interview Marks recently said, “It took seven years to get back to the 2000 highs in 2007. It took 5 1/2 years to get back to the 2007 highs in late 2012. So, is it really appropriate that, given all the bad news in the world today, we should get back to the highs in only three months? That seems inappropriately positive.”

I recently wrote that investors holding a significant cash holding could start reinvesting very gradually in the equity market, over at least a one-year time frame.

Most investors have seen their portfolio fall significantly since the end of 2019, and based on the mail I receive, many are nervous about their portfolio and are not sure what, if anything, they should do. One thing you can do is reevaluate the optimum ratio of stock market to bond market in your portfolio, taking risk into consideration.

Don’t be close-minded when it comes to determin-

ing a stock to bond ratio. Personally, I have used different allocations based on different life stages. When I started investing, I maintained a high stock to bond allocation, investing almost 90% in equities in my 20s and 30s, and 70% in my 40s and early 50s. I believed then, and now, that at the beginning of a career, an investor can take more risk, and invest a higher percent of investments in equities.

By the time I retired (at 58), my allocation was pretty close to 50-50. It is too risky to have a large percentage of your portfolio in stocks, especially at the start of retirement. A significant drop in equity prices at the start of retirement is hard to recover from. However, it is important, even during retirement, to maintain a percentage of equities in order to protect against inflation.

I have been retired now for over 20 years, and I still maintain approximately 50% of my portfolio in diversified equities. I can take some risk because of a generous pension and Social Security.

Individuals without consistent guaranteed income should consider an equity position less than 50%. Rebalance at least annually. By doing that I have retained a great deal of the increase in equities during the long bull market. 🌱

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Past performance is no guarantee of future results. All investments involve risk, including possible loss of principal amount invested. Diversification does not assure a profit or protect against market loss.

The Beauty of Cash

By Jill Schlesinger, Tribune content agency

A spring 2020 survey released by the National Endowment for Financial Education (NEFE) found that 88% of Americans said the pandemic is causing stress on their personal finances. Chief among those stressors was not having enough saved for emergencies. That's not surprising, considering that before COVID-19, an alarming number of people lived perilously close to the financial edge. A Federal Reserve report found that 4 in 10 adults would have difficulty covering a \$400 unexpected expense.

While some live paycheck to paycheck, others have the wherewithal to save, but for



some reason, the boring old rainy day fund never gets the love that it deserves. Considering that the saving rate surged to 33% in April, the highest on record, perhaps now is an ideal time to start, augment, or replenish that fund.

I have heard from many of you, wondering if my advice has changed regarding the emergency reserve funds – the answer is, it has not. I recommend that workers keep six to 12 months of living expenses, in an accessible cash-equivalent account, like a savings, checking, money market or a short-term certificate of deposit. I do not consider access to a home equity line of credit or loan as an emergency fund, nor do I believe that a taxable brokerage account that is fully invested in stocks or other financial assets, can serve this purpose. I am

talking about plain vanilla, folks!

Early in the crisis, many of you wrote in to ask whether emergency reserve funds at various financial institutions were safe. Now that your rational brain is ready, here's a reminder about the Federal Deposit Insurance Corporation ("FDIC"). The FDIC is an independent agency of the government, which protects assets, including savings, checking, money market deposit accounts and CDs, up to \$250,000 per depositor, per insured bank, in the unlikely event of a failure. The agency proudly boasts: "Since the FDIC began operations in 1934, no depositor has ever lost a penny of FDIC-insured deposits."

Credit unions provide similar coverage through the National Credit Union Share Insurance Fund. A different entity backs up money in a brokerage account: the Securities Investor Protection Corporation (SIPC) provides limited coverage in the event that the firm goes broke. SIPC covers up to \$500,000, including up to \$250,000 for cash equivalents. However, SIPC does not cover unregistered investment contracts, unregistered limited partnerships, and interests in gold, silver, or other commodity futures contracts or commodity options.

I love my emergency reserve fund and want you to love yours too, even when the economy is seemingly strong and it feels like a "waste" to have the money earning rotten interest. When the next crisis comes, either systemic or personal, you will be happy to reacquaint yourself with the beauty of cash.



Retirees can skip required minimum distributions (RMDs) from their retirement accounts this year under a provision of the coronavirus economic stabilization package signed into law in March. That means retirees can avoid the tax payments that they normally would face on withdrawals from accounts such as IRAs and 401(k)s. The delay is especially helpful given that the value of many retirement accounts has dropped this year, making it an inopportune time to sell investments. Normally, retirees must start taking RMDs at age 70½ (for those born before July 1, 1949) or at age 72 (for those born after June 30, 1949). Prior to this year, the requirement kicked in at age 70½. Under another provision of the new law, savers under age 59½ can take coronavirus-related "hardship withdrawals" of up to \$100,000 from retirement accounts in 2020 without the 10% penalty that normally applies. They still owe the tax on that withdrawal if they don't recontribute the money within three years, although they have three years to pay the tax. And the new law allows savers to borrow up to \$100,000 from their 401(k)s, double the usual maximum amount. If the loan is not repaid, it is treated as a distribution and is subject to taxes.

Source: CNBC.com 2020

"Today, there are three kinds of people: the haves, the have-nots, and the have-not-paid-for-what-they-haves."

—Earl Wilson

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How to Get Your Retirement Plans Back on Track

By Robert Niedt, *Kiplinger's Personal Finance*

The economy may have upended your retirement plans. Here are steps to get them back on track:

Review your Social Security strategy. You can start taking it at age 62, but your benefits will be permanently reduced by 25% or more. If you can afford it, wait until age 70. That's because every year that you delay your benefit beyond your full retirement age until age 70, your benefit goes up 8%.


Consider a Roth conversion. If your retirement savings are heavily invested in tax-deferred accounts, such as 401(k)s and IRAs, you may want to take advantage of their diminished value and convert to a Roth IRA. You'll pay the taxes now instead of in retirement, and your tax bill will be based on the value of your account when you convert.

Delay major expenses. Financial advisers say we should put the brakes on major expenses, including kitchen and bathroom remodels, while we give our portfolios some time to recover. You'll

be able to use these remodeling funds to increase the amount you're saving.

Follow the 4% rule. If you're a near-retiree or recently retired and you have a well-balanced and diversified portfolio, you should be in a good position to use a strategy known as the 4% rule.

It works like this: You withdraw 4% of your portfolio the first year of retirement. Each year thereafter, you increase the dollar amount of your annual withdrawal by the previous year's inflation rate. For example, if you have a \$1 million nest egg, withdraw \$40,000 the first year of retirement. If inflation that year is 2%, in the second year of retirement you boost your withdrawal to \$40,800.

This formula has its critics — some think it's overly conservative, while others believe it's too risky — but it has held up for me through other tumultuous periods, including the Great Recession of 2008-09. 

This article is for informational purposes only and describes one or more specific course of action that will not be appropriate for everyone. Every decision should be made based on your needs, objective, time horizon, risk tolerance and individual situation.

